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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1938

No. 212

SOUTHERN PACIFIC COMPANY
(a corporation),
Appellant,

vs.

JOHN C. CORBETT, FRED E. STEWART, RICHARD E. COLLINS, WILLIAM G. BONELLI and HARRY B. RILEY, as members of the State Board of Equalization of the State of California, STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, and U. S. WEBB, the Attorney General of the State of California,
Appellees.

BRIEF FOR APPELLANT.

OPINIONS BELOW.

The opinions of the District Court are reported in 20 Fed. Supp. 940 (on motion to dismiss) and 23 Fed. Supp. 193 (on final hearing).

JURISDICTION.

Appellant has filed a statement relating to jurisdiction in accordance with Rule 12 of the Rules of this Court and probable jurisdiction has been noted.

STATEMENT OF THE CASE.

This action was instituted by the appellant to enjoin the appellees, state officers, from enforcing the California Use Tax Act of 1935 (Cal. Stats. 1935, ch. 361, p. 1297), hereinafter referred to as Use Tax Act, with respect to property purchased by appellant outside of the State of California and used by it within said State and in other states in the operation of its inextricably intermingled intrastate, foreign and interstate railroad transportation business. Injunction was prayed for on the grounds, first, that imposition of the tax under said Act, as construed and sought to be applied by appellees, would impose a direct and undue burden on appellant's interstate transportation business in violation of the commerce clause of the federal Constitution; and, second, that imposition of said tax under said Act, as construed and sought to be applied by appellees, on appellant's uses of property partly and inseparably within and without the State of California, on uses outside the State and on uses relating to operations outside the State, in conducting appellant's interstate and foreign transportation business, would be extraterritorial in its operation and effect and would impose a tax upon uses of property beyond the limits of the State of

California in violation of the due process clause of the Fourteenth Amendment to the Constitution of the United States.

A District Court of three judges (Jud. Code, sec. 266; U.S.C. 28:380) denied a motion to dismiss the bill and awarded an interlocutory injunction, holding the tax in question to be a direct, undue and unconstitutional burden on interstate commerce (R. 46, 63). On final hearing the case was submitted on agreed facts (R. 71-93), and the Court found that such agreed facts sustained the pertinent allegations of the bill (R. 94, 100 et seq.).

The agreed facts, as hereinafter summarized, show that the tax in question is a flat-rate excise tax, measured by a percentage of the purchase price, sought to be imposed directly upon the privilege of using instrumentalities in carrying on and conducting inseparably appellant's intrastate, foreign and interstate railroad transportation business. The whole measure of the tax is sought to be imposed upon the privilege of making any storage, use or other consumption of tangible personal property within the State of California, without apportionment as between intrastate, interstate and foreign transportation uses, and without apportionment as to uses wholly within and uses inseparably within and without the State, or uses relating to operations outside the State.

Notwithstanding such facts, the Court reversed the ruling of law made in its first opinion and concluded that the threatened enforcement of the Use Tax Act would not impose a direct or undue burden on appel-

lant's interstate commerce business, and entered a final decree denying a permanent injunction and dismissing the bill. It failed and refused to make any finding and conclusion of law as to the alleged denial of due process (R. 94, 131, 100, 128-131).

From that decree this appeal is prosecuted.

SUMMARY OF FACTS.

The Use Tax Act as here applied imposes an excise tax directly upon one engaged in carrying on interstate and foreign transportation business for the privilege of making necessary use of tangible personal property in the performance of such business (R. 1, 65, 9-19). Section 3 of the Act, so far as material, provides:

> "An excise tax is hereby imposed on the storage, use or other consumption in this State of tangible personal property purchased from a retailer on or after July 1, 1935, for storage, use or other consumption in this State at the rate of three per cent of the sales price of such property.
>
> "Every person storing, using or otherwise consuming in this State tangible personal property purchased from a retailer shall be liable for the tax imposed by this act, and the liability shall not be extinguished until the tax has been paid to this State; * * *."

Section 2(a) defines "storage" as "any keeping or retention in this State for any purpose except sale in the regular course of business of tangible personal

property purchased from a retailer". Section 2(b) defines "use" as "the exercise of any right or power over tangible personal property incident to the ownership of that property, * * *." Section 2(j) defines "in this state" as "within the exterior limits of the State of California, * * *."

Section 4 contains a number of exemptions, one relating to property the gross receipts from the sale of which are taxed by the California Retail Sales Tax Act (Cal. Stats. 1933, ch. 1020, p. 2599). The effect of this exemption is to make the use tax applicable only to tangible personal property purchased outside the State of California. The Act is fully summarized, with pertinent quotations, in the bill of complaint (R. 1, 65, 9 et seq.).

Appellant, a Kentucky corporation, operates as a common carrier of freight and passengers, a system of railroads extending from points within the State of California into other states (R. 100, 101).

Appellant's railroad is contemporaneously, inseparably and inextricably devoted to the services of intrastate, interstate and foreign transportation and commerce, the same rails, the same facilities, and the same organization being devoted to and used inseparably for all three classes of commerce (R. 100, 103, 105).

Appellant purchases the tangible personal property in question for the sole, fixed and predetermined purpose of use in conducting its said transportation business and will continue to purchase like property for such purpose, and so uses the same (R. 106, 118, 119).

The money used for the purchase of said property is operating capital devoted to the service of transportation and all of said purchases are made through the use of such operating capital. The expenses therefor are charged to the appropriate accounts for operation, maintenance or repairs, or other proper account, according to the accounting rules and regulations prescribed for railroads engaged in interstate commerce under the provisions and requirements of the Interstate Commerce Act (R. 106-110).[1]

Materials and supplies and working capital are classed in railway accounting practices, as prescribed by the Interstate Commerce Commission, as railway operating property. The working capital and materials and supplies carried in said accounts are and were a part of appellant's railway operating prop-

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1. Southern Pacific Company is and was subject to valuation by the Interstate Commerce Commission under the Interstate Commerce Act. Its valuation for rate-making purposes was made by the Interstate Commerce Commission and is duly reported in Volume 45 of Interstate Commerce Commission Valuation Reports, page 1 (decided June 10, 1933). Working capital allowed in said valuation was $19,022,826.00, segregated as follows:

Account 706—Cash	$ 5,277,896.00
Account 716—Material and supplies	13,744,730.00

The sum of $27,760,966.88, the amount of working capital as of June 30, 1936, is the approximate amount of working capital devoted to the service of transportation by the appellant at the times pertinent to this action (R. 107, 108).

Numerous authorities support the proposition that working capital and materials and supplies are operative property.

Texas Midland Railroad, 75 I.C.C. 1, 34, held as follows:

"The property of a railroad which is necessary in operation may be divided into two general classes—the plant itself and its operating assets. * * * Operating assets include materials and supplies and cash on hand."

Cumberland Tel. & Tel. Co. v. City of Louisville, 187 Fed. 637 (reversed in part, 225 U.S. 430); *New York & Richmond Gas Co. v. Prendergast*, 19 F.(2d) 167, 177; *Chesapeake & Potomac Telephone Co. v. West*, 7 F. Supp. 214, 224; *New York Telephone Co. v. Prendergast*, 36 F.(2d) 54, 64; *Greenager, Public Utility Rate Making*, p. 123; *Whitten, Valuation of Public Service Corporations*, p. 287.

If the working capital with which purchases are made is devoted to the service of interstate transportation, it follows that the materials and supplies and other property purchased with that capital and for the predetermined purpose of railway operation and maintenance are necessarily devoted to the same service from the moment of their purchase.

erty. Immediately upon the purchase of said property it becomes subject to accounting in the manner and form hereinbefore described (R. 106-110).

The property is of two general classes (a) property purchased to carry out a predetermined renewal or replacement of track, equipment, facilities, or structures in the existing transportation plant (R. 110), and (b) materials for current maintenance, or for use or consumption in conducting current operations, including stand-by materials (R. 110). The major part of the property consists either of articles especially designed and manufactured upon approved specifications for railroad uses, or of articles manufactured upon appellant's particular specifications to meet its particular needs and purposes. Generally such property is unfit for other purposes or cannot be economically used for other purposes (R. 110-112).

As a matter of practical economy, all purchases are made on the basis of estimates and requisitions to meet current requirements and are restricted to the least practical quantities required for imminent future uses (R. 112 et seq.).[2]

In the interest of prompt and efficient public service and in the performance and discharge of its legal obligations to the public as a common carrier by rail-

---

2 The courts and the Interstate Commerce Commission have held repeatedly that property held for imminent use in conducting interstate transportation is devoted to the service of interstate commerce while so held.
Re Texas Midland Railroad, 75 I.C.C. 1, 161, 162;
Jersey City v. Board of Equalization of Taxes, 74 N.J.L. 382;
Chicago, etc. R. Co. v. Douglas County, 122 Wis. 273;
State v. Great Northern Ry. Co., 171 N.W. 317, 142 Minn. 173;
Pere Marquette R. Co. v. Ludington, 133 Mich. 397;
Philadelphia etc. Ry. Co. v. Woodbridge, 102 Atl. 392, 91 N.J.L. 180;
Brooklyn Borough Gas Co. v. Prendergast, 16 F.(2d) 615, 626;
Indianapolis Water Co. v. McCart, 89 F.(2d) 522, at 524

road, appellant is required and compelled to have supplies and facilities distributed over its entire line of railroad in quantities and at the times necessary to anticipate regular current requirements, and to have such reserves in quantities necessary to meet constantly fluctuating demands and emergencies which result from changes in the volume of business handled, traffic accidents, wrecks, weather conditions, washouts, and unforeseen operating conditions which commonly affect a railroad, and to meet the ordinary wear and tear which occur in connection with the use of its railroad and facilities (R. 117-120).

All property purchased as aforesaid is handled from the time the same reaches the rails of the appellant, as company materials, on company material waybills and on free billing, and all of such property when received by appellant as purchaser and thereafter handled by it in distribution over its lines of railroad, is likewise handled on free company billing (R. 113).[3]

The purchasing, handling and distribution of all such property is by the operating personnel of the railroad and at railroad expense, and all handling thereof is upon railroad operating property (R. 112, et seq.).

At no time is the property a part of a commercial stock in trade offered for sale or sold and no part thereof was purchased or held for any purpose or

3. Paragraph 8, section 1 of the Interstate Commerce Act forbids transportation of commodities, with certain exceptions, owned by the railroad, except such articles or commodities as are necessary and intended for its use in the conduct of its business as a common carrier.

purposes other than those herein described (R. 119, 120).

No storage, use or other consumption of any character is made of the property so purchased for appellant's operating uses except as an integral, inseparable and indispensable part of conducting transportation (R. 100-127). There is no storage of the property prior to its use in transportation (R. 100-127, 46, 55, et seq., and final opinion 94).

By reason of its inextricably intermingled interstate, foreign and intrastate commerce and business, plaintiff is compelled to purchase from points outside of California and to use and consume a greater amount of tangible personal property than it would be required to purchase if it were engaged only in intrastate railroad transportation business. Wear and tear and materials consumed have a relation to the tonnage moved (R. 126).

At San Francisco, California, are located the general stores and purchasing departments of the company (R. 103, 104). In addition to the main stores and material yards in California, appellant maintains storehouses, storerooms and materials yards and other places of storage all along its lines of railroad at principal terminals, at division points or at stations. Such places for the holding and detention of railway materials and supplies are parts of a unified distribution system (R. 112-114). Purchasing in quantities through a central purchasing department, transportation in single lots to a single destination, and issuance of materials and supplies from terminal points, con-

stitute the normal and economical method of providing railway materials and supplies; hence, appellant purchases the property in question for direct delivery to California receiving points for redistribution over its lines (R. 103, 104, 106, 112 et seq.).

The general railroad administrative offices and general repair and maintenance shops and yards are located within California. At those points some of the property in question is used for the benefit of the entire system. Such use is not complete in California (R. 5, 7, 8, 66, 103, 104, 112 et seq.).

The appellees, officers of the State of California, and citizens and residents thereof (R. 126, 127), have demanded payment of the taxes aforesaid under the provisions of Ruling No. 11 of the appellee, State Board of Equalization, which is as follows:

> "The fact that tangible personal property is purchased in interstate or foreign commerce does not exempt from the tax the storage, use or other consumption of such property in this State after the shipment of the property in interstate or foreign commerce has ended.
>
> "The fact that tangible personal property is used in this state in interstate or foreign commerce following its storage in this State does not exempt the storage of the property from the tax. The tax does not apply to the use or storage of property purchased for use in interstate or foreign commerce and actually placed in use in interstate or foreign commerce prior to its entry into this State" (R. 126, 127).

Such tax would be a direct charge to the cost of conducting transportation (R. 110, 47; final opinion, 94).

SPECIFICATION OF ERRORS.

The Court erred:

1. In concluding that the imposition of the California use tax upon the acts and transactions found to have occurred with respect to the tangible personal property described in findings of fact would not be a direct burden upon the interstate commerce and business of the appellant and would not be contrary to or in violation of the provisions of Clause 3 of Section 8 of Article I of the Constitution of the United States and the rights, privileges and immunities of the appellant thereunder.

2. In concluding that by reason of the facts found, appellant's application for a permanent injunction should be denied and the bill of complaint should be dismissed.

3. In refusing to make the conclusion of law requested by the appellant that the purchases of tangible personal property involved in this action were made with funds classified as railway operating capital and that the property purchased with such capital was classified as railway operating property from and after the time of its purchase.[1]

4. In refusing to make the conclusion of law requested by the appellant that all of the tangible personal property involved in this action was purchased for the sole, fixed and predetermined purposes of using the same for carrying on appellant's intermixed and inseparable intrastate, interstate and foreign trans-

1. Findings of fact and conclusions of law requested by appellant are shown in record pages 128-131.

portation business and that said property was devoted to the service of transportation and use in carrying on said business from the time of its purchase.

5. In refusing to make the conclusion of law requested by the appellant that any and all storage of the tangible personal property involved in this action made by the appellant within the State of California was not a storage separate or separable from and antecedent to appellant's use in carrying on its intermingled and inseparable intrastate, interstate and foreign transportation business, but was an inseparable part of use in carrying on such business.

6. In refusing to make the conclusion of law requested by the appellant that the tangible personal property purchased for and devoted to appellant's use as materials and supplies for the current operation, repair and renewal of its existing railway transportation plant was for an integral use in appellant's interstate commerce operations and at all times from and after the date of purchase and transportation into the State of California, the storage, use or other consumption of said property by appellant constituted a use in interstate commerce.

7. In refusing to make the conclusion of law requested by the appellant that the tangible personal property purchased for and devoted to an existing renewal and maintenance program was for an integral use in appellant's interstate commerce operations and at all times from and after the date of

purchase and transportation into the State of California, the storage, use or other consumption of such property by appellant constituted a use in interstate commerce.

8. In refusing to make the conclusion of law, requested by the appellant, that the appellant had established that the storage of the tangible personal property involved in this action, solely for its current repairs and renewals and necessary extensions of its intermingled interstate and intrastate enterprise and plant, was a use in interstate commerce.

9. In refusing to make the conclusion of law, requested by the appellant, that the tax proposed to be assessed upon such use is a tax directly upon an interstate commerce use or function.

10. In refusing to make the conclusion of law, requested by the appellant, that the imposition of the said use tax upon storage within California would impose a tax extraterritorial in its operation and would reach to and impose a direct tax and a direct burden upon ultimate uses and consumption in other states of the property so stored or of an inseparable part thereof.

11. In refusing to make the conclusion of law, requested by the appellant, that the use taxes sought to be imposed upon appellant by the appellees under the said Use Tax Act on account of the storage, use or other consumption of the tangible personal property in question, are direct taxes upon operative in-

strumentalities of interstate commerce, a direct burden of expense chargeable to such commerce, and an unconstitutional burden on interstate transportation and interstate commerce, contrary to and in violation of the provisions of Article I, Section 8, Clause 3 of the Constitution of the United States.

12. In refusing to make the conclusion of law requested by the appellant that the said Use Tax Act, as construed and applied by appellees so as to impose a tax on the acts or transactions found to have occurred with respect to the tangible personal property described in said findings of fact, is contrary to and in violation of the provisions of Article I, Section 8, Clause 3, of the Constitution of the United States, and the rights, privileges and immunities of the appellant thereunder.

13. In refusing to make the conclusion of law, requested by the appellant, that the defendants might not constitutionally enforce the provisions of said Use Tax Act against the appellant upon the tangible personal property described in the findings of fact and that appellant was entitled to a permanent injunction.

14. In failing and refusing to make the conclusion of law based upon and justified by the findings of fact herein, that the imposition and collection of the said tax effectuates a taking of appellant's property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States.

15. In deciding, adjudging and decreeing that appellant's application for a permanent injunction should be denied.

16. In deciding, adjudging and decreeing that appellant's bill of complaint should be dismissed.

ARGUMENT.

Summary of Argument.

The trial Court rendered two opinions in this case. The first upheld the sufficiency of the bill of complaint and decided that the tax assailed constituted a direct, undue and unconstitutional burden on interstate commerce, and that conclusion, we submit, was correct. In its final opinion, after making findings of fact showing the direct manner of imposition of the tax upon the appellant's privilege of using instrumentalities of interstate commerce, and stating that the stipulated facts sustained the allegations of the bill of complaint, the Court reversed its earlier opinion and decided that the threatened enforcement of the Use Tax Act would not impose a direct or undue burden on plaintiff's interstate commerce business. The cases of *Western Live Stock v. Bureau*, 303 U. S. 250; *Coverdale v. Pipe Line Co.*, 303 U. S. 604, and *Helvering v. Producers Corp.*, 303 U. S. 376, decided subsequent to the denial of the motion to dismiss the bill, were cited in support of the Court's reversal of its earlier opinion.

We submit that none of those cases is in point and that there is no precedent on which the Court's reversal of its earlier opinion can be based.

Under the doctrine of *Helson and Randolph v. Kentucky,* 279 U. S. 245, which was reaffirmed in *Bingaman v. Golden Eagle Lines* (1936), 297 U. S. 626, and was recognized in *Coverdale v. Pipe Line Co.,* supra, state statutes directly taxing the use of instrumentalities of interstate commerce are unconstitutional as in violation of the commerce clause.

Under *Cooney v. Mountain States Tel. Co.* (1935), 294 U. S. 384, a state excise tax cannot validly be applied indiscriminately and without apportionment to an instrumentality common to interstate and intrastate commerce.

The case at bar is distinguished by its facts from the cases in which the privileges taxed were not acts of conducting interstate transportation.

The unconstitutionality of state excise taxation burdening interstate commerce is not avoided by imposing state taxes at an equal rate on intrastate commerce or other intrastate privileges.

This Court has consistently ruled that where a tax upon the privilege of engaging in interstate commerce is directly imposed, the resulting burden is direct and therefore imposes an undue and unconstitutional burden on interstate commerce.

The tax involved in this case is discriminatory in its operation and effect, and if the decision of the lower Court is sustained the way will be open for

serious discriminatory abuses in state and municipal taxation of the instrumentalities of interstate commerce.

The taxation of the use of property, inseparably used by a railroad interstate carrier in the transaction of its transportation business, both within and without the State of California, without apportionment, would be extraterritorial in its operation and effect and in violation of the due process clause of the federal Constitution.

I.

A STATE EXCISE TAX IMPOSED DIRECTLY UPON THE PRIVILEGE OF USING INSTRUMENTALITIES IN CARRYING ON AND CONDUCTING INTERSTATE AND FOREIGN TRANSPORTATION AND COMMERCE BY A RAILROAD COMMON CARRIER, IS A DIRECT BURDEN ON SUCH TRANSPORTATION AND COMMERCE, CONTRARY TO THE PROVISIONS OF ARTICLE I, SECTION 8, CLAUSE 3, OF THE CONSTITUTION OF THE UNITED STATES.

This proposition is well established:

Bingaman v. Golden Eagle Lines, 297 U. S. 626;

Helson and Randolph v. Kentucky, 279 U. S. 245;

East Ohio Gas Co. v. Tax Commission, 283 U. S. 465;

Ozark Pipe Line v. Monier, 266 U. S. 555;

Oklahoma v. Wells, Fargo & Co., 223 U. S. 298;

Galveston, H. etc. Ry. Co. v. Texas, 210 U. S. 217;

Philadelphia SS. Co. v. Pennsylvania, 122 U. S. 326;

Fargo v. Michigan (Fargo v. Stevens), 121 U. S. 230;

Gloucester Ferry Co. v. Pennsylvania, 114 U. S. 214;

United States Airways v. Shaw (1930), 43 F. (2d) 148;

Mid-Continent Air Express Corporation v. Lujan (1931), 47 F. (2d) 266;

Puget Sound Co. v. Tax Commission, 302 U. S. 90;

Minot v. Philadelphia, W. & B. R. Co., 17 Fed. Cas. 458, Fed. Case No. 9645, aff. 18 Wall. (85 U. S.) 206;

Pullman Southern Car Co. v. Nolan (C. C.), 22 Fed. 276, 280, 281, aff. sub. nom. *Pickard v. Pullman Southern Car Co.,* 117 U. S. 34, 46.

The Pacific Telephone & Telegraph Company v. Henneford (July, 1938), ... Wash. ..... 81 Pac. (2d) 786.

The Act in question specifically states that the tax imposed on the storage, use or other consumption of tangible personal property, etc., is an "excise tax" (R. 9, 10), and the trial Court so ruled (R. 50).

II.

A STATE EXCISE TAX CANNOT VALIDLY BE APPLIED INDISCRIMINATELY AND WITHOUT APPORTIONMENT TO AN INSTRUMENTALITY COMMON TO INTERSTATE AND INTRASTATE COMMERCE.

The same organization, the same lines of track, the same rolling stock and the same materials and supplies are employed and used inseparably in conducting all classes of railroad transportation. The same train carries local and interstate freight or local and interstate passengers.[5]

Under *Cooney v. Mountain States Tel. Co.* (1935), 294 U. S. 384, a state excise tax cannot validly be applied indiscriminately and without apportionment to an instrumentality common to interstate and intrastate commerce. Numerous cases supporting that proposition are cited in the Court's opinion in that case and that principle is sustained in *Adams Mfg. Co. v. Storen* (1938), 304 U. S. 307, 314.

5. Mr. Justice Brandeis delivering the opinion of the Court in *Colorado v. United States*, 271 U. S. 153, said:

"This railroad, like most others, was chartered to engage in both intrastate and interstate commerce. The same instrumentalities serve both. The two services are inextricably intertwined. The extent and manner in which one is performed necessarily affects the performance of the other."

See also to the same effect the case of *Railroad Commission v. C. B. & Q. R. Co.*, 257 U. S. 563.

III.

THE CASE AT BAR IS DISTINGUISHED BY ITS FACTS FROM THE CASES IN WHICH THE PRIVILEGES TAXED WERE NOT ACTS OF CONDUCTING INTERSTATE TRANSPORTATION.

In the case at bar, the trial Court expressly found the use of property in question to be an integral and inseparable part of use in conducting transportation. All storage of current railway materials, etc., is an act of such use (R. 100-127, 46, 55 et seq., and final opinion 94).

In *Edelman v. Boeing Air Transport,* 289 U. S. 249, the tax there in question was upheld on the theory that the privilege taxed was one which was wholly exercised and completed before use in carrying on interstate commerce commenced. That decision was based upon an express finding of fact that the act of "withdrawal" from storage, which was the privilege taxed, was completed before any use in interstate commerce was commenced. A reference to the decision of the lower Court in that case (*Boeing Air Transport, Inc. v. Edelman,* 61 F. (2d) 319), is enlightening in distinguishing the facts of that case from the facts of the case at bar. The lower Court's opinion contains the following recital of facts:

> "Appellant procures gasoline from both inside and outside the State of Wyoming; after it is purchased part of it is brought to Cheyenne and part to Rock Springs and stored in tanks *for use at appellant's direction* and *subject to any use it wishes to make of it;* there is one tank at Rock Springs and two at Cheyenne; the capacity of one

> of the tanks at Cheyenne is five thousand gallons and the other two thousand gallons; *appellant sells some gasoline* at Cheyenne and at Rock Springs; *it displays a price sign at each place, stating the price of gasoline including the tax;* other planes use both of these fields, *and appellant uses gasoline locally at each field in trucks, automobiles, for testing purposes, and washing planes; there is no separate receptacle* at either field *in which appellant stores the gasoline which it sells to other airships,* or buys outside Wyoming; it is all put into the storage tanks; there are gauges on the pumps, and a record was kept each time that gasoline was drawn from the tanks; the amount used locally by appellant, or sold, is in this way kept separately from the amount used by appellant in its interstate flights; it likewise measures the gasoline put into its planes for interstate commerce use." (Emphasis supplied.)

Under those facts, it could not reasonably have been argued that the storage followed the devotion of the gasoline to interstate transportation service, but as the Court held, the storage in that case completely preceded any devotion of the gasoline to or use of it in interstate commerce. The whole supply constituted a commercial stock in trade and the storage of that portion subsequently withdrawn for use in the owner's interstate planes was merely incidental and no part of the gasoline was by any overt act, declared intention or predetermination, devoted to interstate service until the time of its actual withdrawal from the common supply.

In *Nashville, C. & St. L. Ry. v. Wallace,* 288 U. S. 249, this Court decided that the privilege which was taxed was completely exercised before interstate use commenced. The facts of that case, as we take them from the opinion, were as follows:

Appellant, an interstate rail carrier, made purchases of large quantities of gasoline outside the State of Tennessee and brought it into the State in tank cars from which it was unloaded and placed in its own storage tanks. None of it was sold by the appellant but all was withdrawn and used by it as a source of motive power in interstate rail operations in Tennessee, Kentucky, Alabama and Georgia. Storage in that case was a preliminary step to use in interstate commerce. Neither the appellant, the shippers, nor the carrier, at the time of the shipment of the gasoline from points of origin, arranged a destination for any part of the oil other than the appellant's storage tanks in Tennessee. Although in the usual course of business a *variable* and *undefined* part of it, *when segregated for that purpose,* would again be transported across state boundaries, *appellant was free to distribute the oil either within or without the state for use in its business or for any other purpose.*

That appears to be the whole of the facts upon which the opinion was predicated.

The demurrer to the complaint assumed a state of facts showing the storage of gasoline in storage tanks at Nashville, Tennessee, for *future distribution and use* throughout several states in the operations of an

interstate railroad, and it was argued that neither the purchaser's intention for future use, nor an ultimate future use, prevented the imposition of the tax. That this Court's decision rested upon such facts is shown by the following excerpts from the opinion:

> "We cannot say that the tax is a forbidden burden on interstate commerce because appellant uses the gasoline, *subsequent to the incidence of the tax,* as an instrument of interstate commerce. * * *
>
> "There can be no valid objection to the taxation of the exercise of any right or power incident to appellant's *ownership* of gasoline, *which falls short of a tax directly imposed on its use in interstate commerce,* deemed forbidden in Helson v. Kentucky, supra.
>
> "Here the tax is imposed on the successive exercise of two of these powers, the storage and withdrawal from storage of gasoline. Both powers are *completely exercised before use of the gasoline in interstate commerce begins. The tax imposed upon their exercise is, therefore, not one imposed on the use of gasoline as an instrument of commerce."* (Emphasis supplied.)

In deciding the case at bar the Court expressly declared that "the railway has established that the storage use of the railway materials solely for its current repairs and renewals * * * and without which usage the railways would stop running, is a use in interstate commerce" (R. 94). In the first opinion, considering facts related in the bill which the Court later found were sustained by the agreed facts, the

case at bar was distinguished by its facts from the *Nashville* case and *Edelman v. Boeing Air Transport*, the Court saying that the items of property sought to be taxed were devoted to the service of transportation immediately upon their purchase and that any keeping or retention thereof within the State of California was an inseparable part of the use of said materials and each item thereof in interstate commerce and that the situation differs materially from the facts on which those cases were decided (R. 60-62).[6]

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6. We wish to enumerate by way of emphasis some of the distinctions between the facts upon which the *Nashville* case was decided, as recited in the opinion, and the facts of the case at bar:

(a) In the *Nashville* case, while it does appear that none of the gasoline in question was sold and all of it was subsequently used as a source of motive power in interstate railway operations, there is nothing whatever in the facts recited in the opinion to connect the stored gasoline with an unequivocal use in interstate railway operations as are the facts in this case. On the contrary, the opinion expressly declared that the appellant was free to distribute the oil either within or without the State for use in its business *or for any other purpose.*

(b) The opinion recites no facts showing that the gasoline had been purchased for the predetermined purpose of use in conducting transportation. In the case at bar the findings of fact show that the tangible personal property in question was purchased for the sole, fixed, exclusive and predetermined purpose of transportation use.

(c) There are no facts noticed in the opinion in the *Nashville* case showing that the gasoline was purchased with railroad operating capital; or that it became, immediately upon its purchase, subject to classification as railway operating materials and supplies definitely devoted to the service of transportation; or that it was a part of the carrier's investment upon which it was entitled to earn a fair return, and that this status became fixed before the time of the incidence of the tax.

(d) There are no facts noticed in the opinion in the *Nashville* case showing that the railway storage tanks were in themselves a part of the railway operating transportation plant or that the storage and handling of gasoline into and out of such storage and the distribution thereof over the carrier's lines of railway for operating purposes were all an essential and inseparable part of the conducting of transportation.

(e) The opinion takes no notice of any facts showing that the gasoline in question was handled or subject to handling in all respects as company material and that the carrier could not have enjoyed the economy of the free billing of such gasoline over its lines in distribution for use in conducting transportation without first having dedicated the same to that service.

(f) No fact appears in that case, as appears in the case at bar, showing that a large part of the property in question was especially designed for specific railroad purposes and not practically adapted to any other use. The commodity which was involved in the *Nashville* case is not typical of railroad materials and supplies generally used for railroad operation and main-

The opinion in the *Nashville* case clearly accepts the proposition that goods which are presently being used in conducting interstate transportation, are not subject to State taxation for such privilege. That principle is recognized in the express reference to *Helson v. Kentucky,* supra, in distinguishing between present and prospective use of commodities in conducting transportation.

In deciding the case of *Coverdale v. Pipe Line Co.,* 303 U. S. 604, this Court placed it in the category of the cases of *Nashville, C. & St. L. Ry. v. Wallace, Edelman v. Boeing Air Transport,* and *Gregg Dyeing Co. v. Query,* 286 U. S. 472, as involving the taxation of an intrastate event. The event held to be taxable

tenance. It is not a material which by virtue of its character raises a presumption that it is intended for and dedicated to a railroad use, but, on the contrary, gasoline is a commodity subject to merchandising and general uses. Some affirmative evidence indicating a definite act of dedication of that kind of material to such service is essential. Had it been shown that the gasoline had been purchased with railroad operating capital, that overt act would have classified the material as being devoted to the service of transportation immediately upon its purchase and before its incidental storage for subsequent consumption in railway operations. A commercial supply of gasoline might be taxable notwithstanding the fact that some part of it might subsequently be sold or used for power for carrying on interstate transportation; but those facts are different from a storage of materials which have already been set apart, allocated and dedicated by the common carrier itself for current maintenance and operating supplies for conducting interstate transportation. The item of gasoline is not within the issues of the case at bar since it is not purchased in interstate commerce for railroad use in California.

(g) The opinion in the *Nashville* case contains no recital of facts showing that the gasoline on hand was not in excess of a reasonable amount for imminent future uses. Even the cash on hand and cash assets of a railroad are subject to differentiation as between that part which is classified as working capital, subject to regulation, and that part in excess of working capital, taking a non-carrier classification not subject to regulation. The evidence in that case clearly failed to meet the test repeatedly laid down by the authorities, of showing the imminence of future use. The large supply held at one central location and not distributed over the lines at points of convenient use and not shown to be in a process of distribution, was clear evidence to the contrary.

(h) The facts in the *Nashville* case, contrary to those in the case at bar, do not show the extraterritorial operation and effect of the tax on the storage of materials ultimately used in relation to operations extending over state lines.

by the State was the manufacture of power, a process completely accomplished and resulting in a completed production within the taxing state—as distinguished from the use of an instrumentality in carrying on interstate commerce. The tax in question was laid on the privilege of operating 12 gas engines classified as "prime movers", which created mechanical power. The mechanical power after being created by the gas engines was transmitted to compressors which in turn made use of or consumed the power, as a subsequent process, in increasing the pressure in pipe lines used for the transportation of natural gas in interstate transportation. The opinion declared:

> "We regard the tax as one upon the privilege of producing the power."

In describing the distinction between the manufacture of power and the use or consumption of power, it was said in the opinion:

> "While the engine and compressor units are assembled on a common bed plate, their functions are thus seen to be as completely separate as if they were operated through belting. The engine is the 'prime mover' of the tax act, producing power to drive the compressor. While the use of the engine for the production of power synchronizes with the transmission of that power to the compressor, production occurs prior to transmission. It is just as much local as the generation of electrical power."

The manufacture of the power was separable from the subsequent use of that power in the interstate

transportation of gas. The gas company had the option of producing the power itself, subject to the tax, or of purchasing the power from some other producer (such as an electric power company) who would be assessed the same tax. The case at bar does not involve any manufacturing process. The acts of receiving, storing, handling to places of ultimate use and placement in ultimate use, are all acts of use or consumption in the performance of transportation. The tax considered in the *Coverdale* case was not laid upon the privilege of *using* the power, after it was produced, in carrying on interstate transportation. Had the tax been imposed directly upon such use, it clearly would have been a direct burden on interstate commerce and unconstitutional.

In the final opinion in the case at bar, it is argued that "it is true that the standby material here stored for the necessary maintenance of a great interstate railway is dedicated to an interstate use, but so are the pumps in the *Coverdale* case", and that "railways could not run unless their spare parts and maintenance supplies were used in the storage from which they were currently drawn, but neither could the gas be driven in interstate commerce unless the owner used the pumps". But that reasoning states no analogy. The use of the pumps was not being taxed—the *use* of no instrumentality of interstate commerce was being taxed in that case.

It was said in the opinion in the *Coverdale* case that a narrow distinction of facts exists between the tax held invalid in the *Helson* case and the tax considered

valid in the *Nashville* case. That narrow distinction of facts is the distinction which exists between the taxation of an event separable and completed before use in interstate commerce begins and the taxation of an event which is an inseparable part and act of carrying on interstate commerce.

The opinion in the *Coverdale* case classes the *Western Livestock* case with those involving privilege taxes for "carrying on a local business". The privilege taxed in the latter case was the carrying on of a local business of providing and selling advertising space in a publication which was sold to and paid for by subscribers, some of whom received it in interstate commerce. The opinion declared that the business of preparing, printing and publishing magazine advertising is peculiarly local and distinct from the subsequent circulation thereof whether or not that circulation be interstate commerce.

IV.

THE UNCONSTITUTIONALITY OF STATE EXCISE TAXATION BURDENING INTERSTATE COMMERCE IS NOT AVOIDED BY IMPOSING STATE TAXES AT AN EQUAL RATE ON INTRASTATE COMMERCE OR OTHER INTRASTATE PRIVILEGES.

In the case of *Adams Mfg. Co. v. Storen*, 304 U. S. 307, decided at the last term of this Court, it was ruled that the fact that a state tax is non-discriminatory and general in is operation does not save it from being declared invalid if it directly burdens interstate com-

merce. Such was in effect a restatement of the ruling in the following cases:

Crew Levick Co. v. Pennsylvania, 245 U. S. 292;

A. G. Spalding & Bros. v. Edwards, 262 U. S. 66, 69;

Cooney v. Mountain States Tel. Co., 294 U. S. 384, 393;

Philadelphia, etc. Co. v. Pennsylvania, 82 U. S. 232.

In *Bingaman v. Golden Eagle Lines*, the tax in question applied upon either the sale or use of gasoline and equally to local or interstate transportation uses. The tax was held to be a direct burden on interstate transportation and void notwithstanding the equality in the rate and application of the tax. That is the latest decision by this Court on the question of a direct tax upon the privilege of using a material to carry on interstate transportation.

If State excise taxation burdening interstate commerce is to be held constitutional on the theory that an excise tax at an equal rate is imposed on intrastate commerce, then by the same reasoning, the municipalities and other subdivisions of the State could exercise a like taxing power. The result would be that every county, city, town and village in the United States having the power to tax could and undoubtedly would impose excise taxes upon the privilege of using railroad property or maintaining a station or a ticket office or some other action essential to the carrying on of railroad transportation within its boundaries. The

interstate commerce passing over a line of railroad within a given municipal taxing unit might amount to a hundred times the intrastate business subject to taxation within the same area. As distance from seaboard or origin of shipment increases, the intervening states and municipalities could multiply the burden upon interstate commerce by taxing the privileges of engaging in that commerce. The result would be the total destruction of interstate transportation. This was pointed out in the opinion in the *Helson case*, 279 U. S. 245 at 251, quoting from the opinion of Mr. Justice Strong in *Minot v. Philadelphia W. & B. R. Co.*, 2 Abb. (U. S.) 323, 343, Fed. Case No. 9645, wherein it was said:

> "It is of national importance that in regard to such subjects there should be but one regulating power, for if one state can directly tax persons and property passing through it, or indirectly, *by taxing the use of means of transportation*, every other may; thus commercial intercourse between states remote from each other may be destroyed."

V.

THIS TAX IS DIRECTLY IMPOSED UPON THE PRIVILEGE OF ENGAGING IN INTERSTATE COMMERCE AND THEREFORE IS AN UNDUE AND UNCONSTITUTIONAL BURDEN ON SUCH COMMERCE.

From the foregoing statement of facts, including quotations from the Act in question, it is clear that the tax is imposed directly upon the privilege of using property in the operation of an interstate

transportation business.[7] "It is settled that a State may not directly burden interstate commerce, either by taxation or otherwise. But a tax that only indirectly affects the profits or returns from such commerce is not within the rule." (*U. S. Glue Co. v. Oak Creek*, 247 U. S. 321.) "A tax which falls directly upon the use of one of the means by which commerce is carried on directly burdens that commerce." (*Helson and Randolph v. Kentucky*, 279 U. S. 245, 252.)

In applying the general rule that it is not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of the state tax burden, even though it increases the cost of doing business, this Court has consistently observed definite boundaries beyond which state taxation is not permitted. It has never permitted direct taxation by any state of the privilege of engaging in interstate commerce.

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7. In its first opinion the trial Court, in connection with its holding that the property in question was at all times from and after its purchase in transportation service and use, said:

"The storage of such property is a use which is as integral a part of the interstate commerce project as are the rails over which interstate trains are actually running. It is the definite predetermined character of its purpose that makes the storage of these purchased articles of equipment as vital to the entire plant before installation as well as afterwards." (R. 57.)

In its final opinion the Court said:

"The railway has established that the storage use of the railway materials, solely for its current repairs and renewals and necessary extensions of its intermingled interstate and intrastate enterprise and plant, and without which usage the railways would stop running, is a use in interstate commerce. * * * At the hearing we invited further argument and briefing, but the able presentation on behalf of the State has not answered the question, 'In what enterprise other than the intermingled interstate and intrastate railroading is this use in storage for current repairs and replacements, without which the railroad could not operate?' Such storage use for current installation is use in interstate commerce in any realistic sense understood by industrialists and merchants. * * *." (R. 94.)

Western Livestock v. Bureau, 303 U. S. 250, cited by the lower Court in support of the reversal of its earlier opinion in this case, cites many cases and illustrations exemplifying the rule that "even interstate business must pay its own way", but not a single one of such cases or illustrations deals with a tax upon action sanctioned and protected by the commerce clause where the manner of imposition of the tax has been direct. They do not modify or criticize the long established rule that where the tax is directly imposed on an interstate privilege the burden is *ipso facto* direct and therefore unconstitutional.

The first class of cases cited refers to ad valorem property taxes on the instrumentalities employed in commerce, either determined by the fixed location of the property within the taxing state or by a proportion of movable transportation instrumentalities used within and without the taxing state where the fair apportionment is representative of the property within the taxing state during the taxable year or at the date of the incidence of the tax. With that class of cases may also be considered the kind of tax which is in lieu of property taxation, where the thing intended to be taxed is property, and earnings are adopted merely as a measure of value. The decisions in those cases were based on findings that the tax was not upon the privilege of engaging in interstate commerce and only remotely affected operations in interstate commerce. The distinction between the ad valorem taxation of property, although used as an instrumentality of interstate transportation, and a

tax directly imposed upon the privilege of engaging in such commerce or using the instrumentalities thereof has long been recognized in the decisions of this Court and the reasons therefor many times expounded as shown by the cases cited in the opinion in the *Western Livestock* case. In *Cleveland, C. C. & St. L. R. Co. v. Backus,* 154 U. S. 439, this Court said:

> "It has been again and again said by this court that while no state could impose any tax or burden upon the privilege of doing the business of interstate commerce, yet it had the unquestioned right to place a property tax on the instrumentalities engaged in such commerce."
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> *McCulloch v. Maryland,* 4 Wheat. 316, 4 L. Ed. 579;
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> *Leloup v. Port of Mobile,* 127 U. S. 640;
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> *Adams Express Co. v. Ohio,* 166 U. S. 185, 218.

Apart from the distinction between a direct and a remote burden on interstate commerce, there is a further reason for the approval of non-discriminatory ad valorem taxation of property used in carrying on interstate commerce within the State, and at the same time denying the power of the State to impose a tax directly upon the privilege of engaging in interstate commerce. That reason lies in the difference between the origin of the right of property ownership and the right of engaging in interstate commerce. This Court has approved the principle that a state cannot tax a privilege which it is without power to grant, control or withhold, and which, on the other

hand, is exclusively within the power of the federal government to grant, control or withhold.

In *McCulloch v. Maryland*, 4 Wheat. 316, at 429, it was said:

> "All subjects over which the sovereign power of a state extends, are objects of taxation: but those over which it does not extend, are, upon the soundest principles, exempt from taxation. This proposition may almost be pronounced self-evident.
>
> "The sovereignty of a state extends to everything which exists by its own authority, or is introduced by its permission; but does it extend to those means which are employed by Congress to carry into execution—powers conferred on that body by the people of the United States? We think it demonstrable that it does not. Those powers are not given by the people of a single state. They are given by the people of the United States, to a government whose laws, made in pursuance of the constitution, are declared to be supreme. Consequently, the people of a single state cannot confer a sovereignty which will extend over them.
>
> "If we measure the power of taxation residing in a state, by the extent of sovereignty which the people of a single state possess, and can confer on its government, we have an intelligible standard, applicable to every case to which the power may be applied. We have a principle which leaves the power of taxing the people and property of a state unimpaired; which leaves to a state the command of all its resources, and which places beyond its reach, all those powers

which are conferred by the people of the United States on the government of the Union, and all those means which are given for the purpose of carrying those powers into execution. We have a principle which is safe for the states, and safe for the Union. We are relieved, as we ought to be, from clashing sovereignty; from interfering powers; from a repugnancy between a right in one government to pull down what there is an acknowledged right in another to build up; from the incompatibility of a right in one government to destroy what there is a right in another to preserve."

Similarily in *James v. Dravo Contracting Company*, 302 U. S. 134, the Court said:

"But the difference is plain. Persons have a constitutional right to engage in interstate commerce free from burdens imposed by a state tax upon the business which constitutes such commerce or the privilege of engaging in it or the receipts as such derived from it. Minnesota Rate Cases (Simpson v. Shepard), 230 U. S. 352, 400, 57 L. Ed. 1511, 1542, 33 S. Ct. 729, 48 L. R. A. (N. S.) 1151, Ann. Cas. 1916A, 18. Interstate commerce is not an abstraction; it connotes the transactions of those engaged in it and they enjoy the described immunity in their own right."

California v. Central Pacific R. Co., 127 U. S. 1; *Anglo-Chilean Nitrate Sales Corp. v. Alabama*, 288 U. S. 218.

The right of property ownership existed before the federal constitution was adopted, and no delegation of power to the federal government to regulate that

right is in the Constitution. The right to engage in interstate commerce does not depend in any degree upon sanction of any of the states.

In ad valorem property taxation, there does not exist the risk of discrimination or multiplied or extra-territorial taxation which is possible in privilege taxation. As this Court, speaking through Mr. Justice Holmes, said in *Galveston, Harrisburg &c. Ry. Co. v. Texas*, 210 U. S. 217, 227:

> "The State must be allowed to tax the property and to tax it at its actual value as a going concern. On the other hand the State cannot tax the interstate business. The two necessities hardly admit of an absolute logical reconciliation. Yet the distinction is not without sense. When a legislature is trying simply to value property, it is less likely to attempt to or effect injurious regulation than when it is aiming directly at the receipts from interstate commerce."

Upholding ad valorem property taxation of property used in carrying on interstate transportation, while denying the right of a state to impose excise taxation upon the privilege of engaging in interstate transportation or using the instrumentalities thereof, is analogous in one respect to the difference which has been recognized by this Court between state taxation of net income derived from transactions in interstate commerce, which has been upheld, and the taxation of gross income derived from interstate commerce which has been condemned.[8] The taxation of net income,

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8. *U. S. Glue Co. v. Oak Creek*, 247 U. S. 321.
Franchise, license, occupation, or other excise taxes measured by the gross receipts of companies engaged in interstate commerce are invalid: *New*

ike ad valorem property taxation, has a definite tie to value. A tax based on net income is a percentage of a realized value.

In ad valorem property taxation the value used as the taxing base is like net income because value of property in any commercial sense is its *net earning value*, present and prospective. Property is not valued by its *gross rental*. Property value does not depend upon the earnings of a defined period; it may have a prospective or speculative value. While use of business property might not immediately be profitable in the hands of one owner, it has intrinsically a use value in the hands of some user, if it has any value at all. If it had no net earning capacity whatever, present or prospective, in the hands of anyone, or for any use, it would have no value to be taxed and no one would claim the ownership of such property or pay taxes on it.[9]

While net income taxation, like ad valorem property taxation, has a tie to net value, privilege taxation when not measured by a net return of the privilege taxed does not have a fixed relation to net value or to a realized profit. A franchise or privilege is taxed only for the period of the exercise of the privilege taxed; the right taxed having been completely exer-

Jersey Telephone Co. v. Tax Board, 280 U. S. 338, 349; *East Ohio Gas Co. v. Tax Commission*, 283 U. S. 465; *Matson Navigation Co. v. Tax Board*, 297 U. S. 441, 444; *Fisher's Blend Station v. Tax Commission*, 297 U. S. 650, 655-656; *Puget Sound Stevedoring Co. v. Tax Commission*, 302 U. S. 90, 94; unless based solely upon gross receipts from local business, *Pacific Telephone Co. v. Tax Commission*, 297 U. S. 403, 415, 416.

9. *Cleveland, etc. Ry. Co. v. Backus*, 154 U. S. 439, 445;
Boom Company v. Patterson, 98 U. S. 403;
Somers v. City of Meriden, 119 Conn. 5, 95 A. L. R. 434, note 442, 445;
Schmidt v. Saline County, 122 Neb. 56;
Railroad and Telephone Cos. v. Board, 85 Fed. 302.

cised or the taxable period having expired, nothing remains to have a prospective value. But that is not true of capital property. In the taxation of storage, use or other consumption of property, the privilege might be entirely exercised without producing any profit. A railroad might pay its use taxes for the use of materials and supplies or other instrumentalities of commerce which are entirely consumed during a fiscal year when its operations are conducted at a loss. Nothing would remain of such consumed properties or as a residue of such privilege out of which loss could be recouped by prospective operations, although its capital plant might remain with its prospective earning capacity or salvage value.

It can be said of the tax in question in the case at bar, amounting to more than $300,000, and continuing to accrue in large amounts, as was said by this Court in *United States Glue Company v. Oak Creek*, 247 U. S. 321, that "conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce". Contrasting a tax upon gross receipts, the Court continued (p. 329):

> "A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, * * * Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, *like a tax upon property, or upon franchises treated as property.*" (Emphasis supplied.)

Thus we see there is a real distinction between taxation which has a tie to value, or to net income as representing a realized value, and that which is without such limitation.

In *Western Livestock v. Bureau*, supra (p. 260), the Court assigned as an added reason why the tax there in question, sustained as being laid upon a local privilege, was not subject to the objection which has been leveled at taxes laid upon gross receipts derived from interstate commerce, that the tax is not one which in form or substance can be repeated by other states. The Court did not say and surely did not intend to imply that because a tax may not be imposed by more than one state, that fact alone, excluding all other objections, would justify any state in levying a tax directly upon a privilege of conducting interstate transportation. The bare fact that the action taxed was performed wholly within one state would not obviate the constitutional objections which are pointed out herein, for example, that the tax was directly imposed upon an interstate privilege, was extraterritorial in its operation and effect or was otherwise discriminatory. Gross income from interstate commerce might be earned by a railroad operating wholly within one state, but that state could not tax such gross income as the price of the privilege of carrying on interstate commerce.

Other cases cited in *Western Livestock v. Bureau*, as illustrative of the limits upon a state's taxing powers, relate to the taxation of local or intrastate

privileges, within the state's power to grant, regulate or withhold, and none of them have reference to the direct taxation of the privilege of engaging in interstate commerce.

Helvering v. Producers Corp., 303 U. S. 376, is cited in the trial Court's final opinion in the case at bar as one of the cases, dealing with the boundaries of state and federal taxation, which prompted it to reconsider its earlier opinion. That case upheld a federal income tax upon the proceeds of the production of oil and gas from lands leased from the state, on the ground that the effect of the tax on the state function of leasing the lands was only indirect and remote. We submit that the case is not in point.

The rule of non-discrimination against goods having an out of state origin is applicable only to cases where the tax is imposed upon a local privilege and the tax burden on interstate commerce is indirect. As this Court has frequently said (supra page 28), the generality of the application of the tax, its compensatory features or lack of discrimination do not save the tax if it is directly imposed. The taxes which this Court has upheld as not discriminatory against goods having an out of state origin (as in *Henneford v. Silas Mason Co.*, 300 U. S. 577; *Gregg Dyeing Company v. Query*, 286 U. S. 472; *Sonneborn v. Cureton*, 262 U. S. 506, and *Hinson v. Lott*, 8 Wall. 148[10]) have

10. In *Hinson v. Lott*, supra, the tax was not upon interstate commerce but was on the purely local privilege of sale of liquors. That tax on local sales was complementary to a tax which applied to local manufacture at the same rate per gallon. By previous sections of the same Act, a tax of 50c

been characterized by several important features: Preliminarily, it should be noted that no tax upon an interstate use was involved in those cases, as there is in the case at bar. In the next place, in those cases the sales and use taxes, taken together, were both consumers' taxes imposed upon the same class of persons and the same class of privileges.[11] In the case at bar, however, the California use tax, alleged to be complementary to the California sales tax, is a consumer's tax (and as here applied is a tax upon the privilege of carrying on interstate commerce) while the sales tax is imposed upon the local privilege of

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per gallon was imposed on all whiskey and all brandy from fruits manufactured in the State and the sales tax was of the same amount.

The taxing statute in question provided:

> "Before it shall be lawful for any dealer or dealers in spirituous liquors to offer any such liquors for sale within the limits of this State, such dealer or dealers introducing any such liquor into the State shall first pay the tax collector of the county into which such liquors are introduced, a tax of 50¢ per gallon upon each and every gallon thereof."

In the opinion it was said:

> "And it is clear that whereas collecting the tax of the distiller was supposed to be the most expedient mode of securing its payment, as to liquors manufactured within the State, the tax on those who sold liquors brought in from other states was only the complementary provision necessary to make the tax equal on all liquors sold in the State."

11. The tax considered by this Court in the case of *Henneford v. Silas Mason Co.*, the so-called compensating tax was a use or consumers' tax. Likewise, the Washington sales tax (Revenue Act of 1935, p. 180, Session Laws 1935) was a consumers' tax—specifically not a tax upon the privilege of carrying on the business of retailing—so that all consumers, whether purchasing locally or in interstate or foreign commerce paid the same consumers' tax. See the case of *Morrow v. Henneford*, 47 P. (2d) 1016.

In the *Gregg Dyeing Company* case, this Court accepted the State's interpretation of its taxing policy and considered the statutes held to be *in pari materia* as each being statutes imposing in effect a consumers' tax. In the Court's opinion it is pointed out that by the kindred acts "all uses are taxed." Although the tax is referred to as a tax on the dealers from whom the consumers buy, in the same sentence it is declared that the consumers pay the tax and, repeatedly, throughout the decision, the Court has referred to the equal burden of tax resting upon the consumer and clearly refers to the tax collected through the dealers as one resting upon the privilege of use or storage for use. The opinion shows that the Court was considering only the question of difference in tax burden between classes of consumers based on the State's theory that the tax was upon use or storage for use, although collected through the agency of the retailer. No suggestion appears to have been made that different kinds of privileges were taxed.

carrying on the business of retailing—not a transactions tax nor a tax upon the purchaser or consumer. In other words, the tax as imposed under the respective acts apply to different classes of persons and to entirely different privileges. In the third place, while the California Retail Sales Tax Act indicates the source from which the retailer is authorized to reimburse himself for the amount of the sales tax, there is nothing in the law which imposes the tax upon the consumer or compels the retailer to exact the tax from his customer. He may bury the tax in his selling price or waive its collection.[12]

While the purpose to protect local merchants or manufacturers by compensating taxes applying exclusively to local privileges, such as was approved in *Henneford v. Silas Mason Co.,* might find some justification, such purpose does not aid the constitutionality of the effort to place a direct burden upon the privilege of using instrumentalities in carrying on interstate transportation. The attempt to impose such a compensating tax assumes the possibility of measuring a differential in tax burden between the California retailer and the out-of-state retailers of many states selling goods to California consumers. To know the comparative tax burdens falling upon local privileges in a single jurisdiction is possible, but to know the comparative tax burden of the intrastate

12. Chap. 1020, Cal. Stats. 1933; Chaps. 351, 355, 357 Stats. 1935; Chaps. 400 and 778 Stats. 1937;
Meyer Construction Co. v. Corbett (three judge U. S. D. C.), 7 Fed. Supp. 616;
National Ice and Cold Storage Co. v. Pacific Fruit Express Co. (1938), 95 Cal. Dec. 442, 455; ..... Cal. Rep. .....

compared to the interstate retailers of different states, it would be necessary to know the whole measure of the tax burden resting respectively upon each of them. Each state has its own separate taxing policy and there is no uniformity in taxing laws among the several states. While the California merchant pays a sales tax, the competing merchant in another state may be under higher property taxation, some other form of or higher license taxes, higher income taxes, some special manufacturer's tax, etc. If every state in the Union were at liberty to equalize some particular tax disadvantage of its manufacturer or tradesman by placing upon imports into such state, some kind of a compensating tax as a restraint upon interstate competition, at the same time maintaining a favorable tax imposition upon its home industries in all other respects, the freedom of interstate commerce would be at an end. Whatever the state may do as to its plan of local taxation, in setting up a tax system which involves the privilege of conducting interstate transportation, it certainly has no right to speculate as to the comparative tax burden resting upon local retailers and those engaged in interstate commerce in supplying transportation companies with the instrumentalities for carrying on interstate transportation.

In another respect, such direct taxation of the privilege of conducting interstate transportation as is attempted in the case at bar, holds possibilities of discrimination against interstate commerce. A large number of articles are already exempt from the California sales tax and use tax. For example, under the

Sales Tax Act as amended, gas, electricity, water, certain gold products, certain motor vehicle fuel, food products, sales of certain vessels constructed in California, sales by the producer of products of the soil and all sales which are not made in due course of the business of retailing, are not taxable. The existence of these exemptions with respect to goods purchased within the state is an obvious discrimination against those who, like the appellant, find it necessary to purchase large amounts of property outside the state.[13]

The Use Tax Act is discriminatory in the respect that it fails to provide any exemption for sales or other excise taxes which may be imposed upon the same property by other states before its sale in interstate commerce to purchasers in California. (R. 9-13.) An exemption of that character was provided in the tax law considered by this Court in the case of *Henneford v. Silas Mason Co.*, 300 U. S. 577.

Furthermore, to the extent that railway operating supplies and equipment purchased in interstate commerce are not available for purchase within the state and therefore not competitive with goods sold by local retailers, the use tax would not be a true compensating tax even though uniformly imposed on uses instead of on different privileges. Since this Court decided the case of *Henneford v. Silas Mason Co.*, supra, holding the Washington compensating tax valid in

13. The allegations of the bill of complaint to the effect that the greater proportions of the items purchased by appellant during the second quarter period (1936), and thereafter to be purchased, are not manufactured or produced in California and were not and are not competitive with California industries, were admitted by the answer. (R. 21, 65.) The appellant's purchases in interstate commerce since March 31, 1936, amounts to some ten million dollars.

application to local uses, the Supreme Court of the State of Washington in the case of *The Pacific Telephone & Telegraph Co. v. Henneford* (July 1938), ... Wash. ....., 81 Pac. (2d) 786, has decided that the said tax is not a true compensating tax because the property involved in that case was not competitive with goods sold by local retailers within the State of Washington.

In the case at bar it is admitted that the object and intent of the California Use Tax Act was to protect California industry from outside competition. Even in the absence of such an admission, this Court has declared in the *Silas Mason* case as to a similar use tax act, that the purpose of such legislation is to protect local dealers against interstate competition. It is also admitted that the majority of the property purchased by plaintiff and sought to be subjected to the tax was property which was not and is not manufactured or produced in California, and therefore not competitive with California industry. Particular items of said property are track materials, car and locomotive parts, manufactured steel tires, timber, sheet steel, steel tires, car heating parts, pile driver parts, locomotive journal grease, steel tubing and numerous other items not manufactured or produced in California. (R. 21, 65.) Therefore, the tax in question, as to such non-competitive materials, is not truly compensating, but is wholly discriminatory as to all property not manufactured or produced within the State. Such discriminations constitute a direct and undue burden.

VI.

THE TAX IS EXTRATERRITORIAL IN ITS OPERATION AND EFFECT AND IN VIOLATION OF THE DUE PROCESS CLAUSE OF THE FEDERAL CONSTITUTION.

The Use Tax Act imposes a flat-rate tax without apportionment for property inseparably used by a railroad interstate carrier in the transaction of its transportation business both within and without the State of California.

The foregoing statement of facts shows that appellant's general stores and purchasing department are located in California and that purchases of railroad materials and supplies are made and shipped to a single California destination and thence distributed through its unified distribution system over its lines in the several states. In the normal conduct of the railroad business, materials and supplies must be issued from terminal points for maintenance of plant and equipment and operation of trains. Supply cars and work trains take on their supplies at California terminals.

Train supplies which are issued at California terminals for the servicing of the train on line and for power for locomotives, repair parts, etc., for trains in interstate runs, would be partly consumed within the state, but their ultimate or completed physical use or consumption would not occur until such materials or an indeterminable part thereof have been moved out of the state in course of the movement of trains.

A large and substantial part of the materials and supplies and other articles of tangible personal prop-

erty are used in connection with overhead operations carried on and performed within California because of the fact that general repair and maintenance shops and yards for the entire system are located within the state and are operated for the use of said entire railway system. A repair part might be applied to a freight car at a California shop and the car immediately be moved out of the state in course of normal railroad operation and remain in out of state service for many months.

In a further respect, the tax would affect out of state operations and that is in connection with materials and supplies, etc., used for general offices located within California. Materials, supplies, etc., used in connection with the general system management located in California, are an expense to transportation in whatever state the actual transportation occurs because such overhead extends to the entire system and a tax expense imposed directly upon general management is a tax expense and tax burden apportionable to conducting transportation wherever the same is performed. (*Norfolk etc. Railroad Co. v. Penn*, 136 U. S. 114, 120.)

An unapportioned tax upon the privilege of storage, use or consumption of property in such overhead operations of an interstate railroad would be a tax upon railroad operations extending over state lines or a tax upon ultimate uses in other states.

When the full measure of the use tax is imposed upon an inseparable part of use, a small part of which use might occur within California, the remaining use

occurring in other states, such imposition makes a direct tax and burden on the operations of interstate commerce in other states.

It is settled that a state cannot, in the guise of excise taxation, impose charges which result in taxing things, actions or privileges wholly beyond her jurisdiction and control. Such a tax is in conflict with the due process clause of the Fourteenth Amendment to the Constitution of the United States.

James v. Dravo Contracting Company, 302 U. S. 134;

Connecticut Gen'l Life Ins. Co. v. Johnson, 303 U. S. 77;

Frick v. Pennsylvania, 268 U. S. 473;

Great Atlantic & Pacific Tea Company v. Grosjean, 301 U. S. 412;

International Paper Co. v. Massachusetts, 246 U. S. 135.

We respectfully submit that the decree should be reversed, with instructions to the trial Court to grant the relief sought by appellant.

Dated, San Francisco, California,
November 10, 1938.

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